TESTIMONY OF

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CHAIRMAN, PRESIDENT AND CEO OF UNITED AIRLINES

BEFORE THE

HOUSE OF REPRESENTATIVES

HOUSE TRANSPORTATION AND INFRASTRUCTURE COMMITTEE

SUBCOMMITTEE ON AVIATION

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Introduction

Chairman Mica, Ranking Member DeFazio, and other distinguished members of this Subcommittee, I appreciate the opportunity to appear at today's hearing and share United Airlines' views on the financial condition of the airline industry with a focus on the industry's economic self-help initiatives.

As members of this Committee, you know that the aviation industry is an important engine driving the U.S. and the global economies. Toward that end, United, United Express and Ted operate more than 3,500 flights a day to 193 domestic and international destinations from our hubs in Los Angeles, San Francisco, Denver, Chicago and Washington, DC. United is America's largest international carrier (measured by Revenue Passenger Miles) with key global air rights in the Asia Pacific region and Europe and, through our membership in the Star Alliance, connections for our customers to 700 destinations in 120 countries worldwide. United's nearly 63,000 employees reside in every state in the U.S and in many countries around the world.

Economic Impacts of September 11th Are Still with Us

Let me start by echoing and supporting the testimony that the Air Transport Association (ATA) submitted for the record on the overall financial condition of the industry, especially on the issues of high fuel prices, the increasing burden of taxes and fees, concern over security fees, and the continued need for war risk insurance.

> "The economic health of the U.S. airline industry remains tenuous, in spite of passenger volumes returning to pre-9/11 numbers. At the beginning of the year, the industry held out hope for a return to some degree of stability, if not profitability. Yet, new costs beyond our control wiped out recent efforts to cut costs and achieve new efficiencies. Record high oil prices and the nation's on-going war on terrorism, including sustained uncertainty in Iraq, have presented new barriers to improving the industry's economic health."
>
> - Air Transportation Association's Statement for the Record, June 3, 2004

Mr. Chairman, the United family was directly and greatly harmed by the attacks of September 11, 2001, when two of our aircraft were hijacked by terrorists. On that day, we lost devoted crew members, passengers, family and friends.

Also, on that day the entire commercial aviation industry was grounded for the first time in history triggering the single most severe economic and financial crisis the industry has ever experienced…an economic impact that is still with us today.

As many of my colleagues have stated in their testimony our industry is facing: rapidly increasing security taxes, costs, mandates and directives in response to preventing another commercial aviation terrorist attack; escalating fuel prices related to the threat of the oil supply in the Middle East; terrorist-related domestic and international revenue vulnerability, new daily security threats, and deteriorating and skittish financial/credit markets. In short, although the industry has seen short-term passenger traffic return since 9/11, it has forever changed our business equation.

We and the rest of the industry are profoundly grateful to Congress for recognizing the severe financial impact of September 11th and its long-term effects on the aviation industry. The Federal assistance provided by Congress is helping to stabilize the industry and has assisted with the extraordinarily difficult challenges post 9/11.

United's Platform

The focus of my testimony today, however, will be on the economic self-help initiatives United Airlines has taken since September 11th. I will share with you what the people and partners of United have done to reposition the company for success during what are clearly the economic "worst of times" for this industry. And what we are doing every day to meet the constantly changing challenges of this highly competitive industry.

The two most important issues facing United and our industry overall since 9/11 are costs and competitive flexibility.

At United, we immediately brought new critical cost discipline to our thinking and to our work. We demanded that hard, fact-based, analytical work would be required if we were to address these challenges and put this company on the road to becoming a leader in long-term cost competitiveness.

Secondly, we had to address flexibility: of our workforce; of our product portfolio; and of our business plan to respond to both new competitive challenges and opportunities.

We segmented our work on two distinct tracks: run a good restructuring and run an excellent airline, now and in the future, for our customers. We knew that to be successful we had to do good work on both tracks.

Restructuring: Costs and Flexibility

The cardinal rules we set down for our restructuring are very straightforward: Take the time necessary to do the job well. Take advantage of the tools afforded us by the Bankruptcy Code – that is what Chapter 11 is designed for. Do it right, do it once and never come back.

United's cost structure has gone from being among the highest, to being among the most cost-competitive of network carriers. By next year, our costs will have been reduced by $5 billion annually; overall that is a 30 percent reduction of our costs.

United's employees understand the changes that must be made to successfully meet the new business reality. They accept it. And, as reflected in our new, consensual six-year labor agreements, they are helping to do what is necessary to get this company on competitive footing again.

As part of this cost-reduction effort, our employees agreed to significant wage reductions that deliver $2.5 billion in annual savings. This is their investment in United's future. That translates in some cases to a reduction in pay of as much as 40 percent. It is important to note that these consensual collective bargaining agreements with United's employees include no snap-back or wage re-openers. In fact, on average, wages will grow just over one percent annually over the six year term.

They also agreed to unprecedented work rule and scope changes that allow United the flexibility in workforce and product portfolio that we need to be competitive. We now have the code share authority we need to partner with other carriers where United lacks network coverage. We can deploy regional jets wherever it makes sense for our business and for our connecting passengers. We have gained the authority to use marketplace flexibility to United's competitive advantage.

Let me give you two examples:

- As reported in the Washington Post on Tuesday, June 1st, our San Francisco maintenance base is being transformed into a cost-competitive, best-practice organization with improved quality control and in-sourcing revenue opportunities that will actually contribute incremental revenue to the company by securing business from clients, such as Air China.
- A senior captain flying a Boeing 737 or Airbus 320 is flying approximately 15 more hours per month with a 37 percent reduction in wages. This is one of the cost factors making the launch of our low-fare carrier, Ted, possible and successful.

Our employees also agreed to reductions in pension benefits that have brought United pension benefits in line with what the rest of the market offers. These savings, in conjunction with the careful restructuring of the company's finances and the Pension Funding Equity Act of 2004, make it possible for us to successfully fund our pension plans going forward and not put the burden on the U.S. taxpayer through distressed terminations.

In addition to getting our labor costs to market rates, we have also been working very closely with all our business partners to bring down costs. We have marked these contracts to the market to provide a sound foundation that is cost competitive. And I might note that our Creditors Committee has been engaged and supportive throughout our entire restructuring.

We have renegotiated new multi-year contracts with the majority of our suppliers, ranging from Fortune 100 corporations to small businesses, resulting in hundreds of millions of dollars in cost savings. We are focused on durable savings, though, so we are not looking just at price reductions. We also are simplifying, standardizing and making more efficient our entire approach to purchasing and partnering with suppliers.

Through a fleet restructuring effort that includes renegotiated contracts, rejections of planes and the sale and retirement of aircraft, we are on track to save $900 million in annual aircraft ownership costs. This 44 percent reduction comes not only from lower financing rates, but also from the rejection of excess capacity.

Our United Express carriers have agreed to new contracts with cost structures at market levels which result in $350 million in annual savings by 2007. New service providers, including some of the most highly acclaimed regional airlines in the country, have joined us at those market rates. They receive a market margin for their businesses and become part of United Express, including sharing the reputation for reliability and safety that we demand of ourselves and of them. In this way, United continues to provide critical, cost-effective service to hundreds of medium-sized and smaller markets all across this nation.

In this process, we have also taken steps to ingrain continuous improvement in our cost reduction initiatives. These significant steps will deliver $900 million in annual savings by 2005 and we have targeted an additional $300 million in cost savings. This comes from rethinking everything we do and becoming better, faster, more efficient and less costly, through initiatives such as strategic sourcing and implementation of best practices programs in maintenance and airport operations. Through these efforts we achieved more than $500 million in cost savings in 2003, $175 million better than our plan.

Running an Excellent Airline

As I said earlier, we have also been concentrating on the second track of our work: running an excellent airline.

Our customers do not want, nor should they be a part of our restructuring. They expect that in today's competitive environment we should be doing more to earn and retain their loyalty -- not less. All of us at United understand this and our employees have delivered exceptional operational performance and customer service despite the distractions and challenges.

In 2003, United recorded the best full-year operational performance in its history. We led the seven major carriers in full-year on-time performance in 2002 and were second in 2003. United employees earned the second-highest customer satisfaction ratings we have ever had in 2003. First-quarter 2004 customer satisfaction ratings continued that trend, with all time highs for the quarter in several categories.

We also aligned the interests and goals of all our employees with those of our customers through the launch of our Success Sharing Program. All employees from the front-line employees to senior management alike receive a bonus based on achieving the same quarterly and annual goals – operating and financial measures that each of us can influence every day. When United meets these goals, our employees get a check, as they did in April when we exceeded our operational and customer goals. That creates a powerful connection between day-to-day jobs and United's overall ability to compete.

The Future

The work we have done has established a strong platform for us to build on at United. Today, we are executing against a solid business plan that is delivering results: our unit revenue was up 14 percent in the first quarter, while our unit cost, excluding fuel, was down 14 percent -- both these improvements far outpacing the industry. United dramatically reduced our loss in the first quarter of 2004 compared to last year. We expect to record an operating profit in one of the next two quarters. Were it not for the extraordinary fuel prices we are currently experiencing, I would be able to appear before you today and say with some certainty that we would be profitable in this quarter.

But we are also aware that while we are constructing a strong platform, it is only the foundation. We know that we are only at the beginning of our task to create the airline we must be to succeed and be profitable for the future. However, we believe United today is a company with the right combination of assets and attitude to succeed. We are building a resilient competitive advantage in changing market conditions by maintaining our focus on operational excellence and continuously improving cost containment. We are achieving profitable revenue generation in a fluid and difficult market by focusing on excellent execution and optimizing the flexibility of our workforce, product portfolio and network strategy.

There has been a lot of conjecture recently about the demise of the network carriers. We believe that there will be point-to-point, so-called low-cost carriers (LCCs) in the future and network carriers like United, which provide a level of connectivity and global service the LCCs just cannot match. No single network carrier or LCC is guaranteed survival. The company that does the best work with the best execution is the company that will win.

There is never anything in this business that is going to be easy. As summarized by the Air Transport Association:

> "The U. S. airline industry remains in a precarious economic condition. From 2001 through 2003 it suffered a net loss of $23.2 billion, plus an additional $1.6 billion in the first quarter of 2004, with full year 2004 losses expected to exceed $3 billion…..Even for those few low cost carriers who have managed to eke out a profit, margins are slim…"
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> -Air Transportation Association's Statement for the Record, June 3, 2004

But United is much stronger for having gone through the experience of restructuring. We are managing superb assets. We are rebuilding our renowned brand. We are re-engaging our loyal customers in a way that will differentiate us in the marketplace. We are creating the cost structure and leveraging our newfound flexibility. And rest assured that United will always make safety and security our foremost priority.

We have learned from that experience and we are dedicated to continuing to learn from the reality we face in the future. We are not slowing down. We will apply the discipline and the rigor of restructuring that we have learned in Chapter 11 to the ongoing success of United.

Thank you for your time and attention.